POGO PRODUCING CO
Form 10-Q
August 02, 2005

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**ý Quarterly report pursuant to section 13 or 15(d) of the Securities**

**Exchange Act of 1934**

**For the quarterly period ended June 30, 2005**

**or**

**o Transition report pursuant to section 13 or 15(d) of the Securities**

**Exchange Act of 1934**

**For the transition period from to**

**Commission file number 1-7792**

# POGO PRODUCING COMPANY

(Exact Name of Registrant as Specified in Its Charter)

| **Delaware** | **74-1659398** |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **5 Greenway Plaza, Suite 2700 Houston, Texas** | **77046-0504** |
| (Address of principal executive offices) | (Zip Code) |

**(713) 297-5000**
(Registrant s Telephone Number, Including Area Code)

**Not Applicable**
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2): Yes ý No o

Registrant s number of common shares outstanding as of July 28, 2005: 59,713,614

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**POGO PRODUCING COMPANY AND SUBSIDIARIES**

**Consolidated Statements of Income (Unaudited)**

| | Three Months Ended June 30, 2005 | Three Months Ended June 30, 2004 | Six Months Ended June 30, 2005 | Six Months Ended June 30, 2004 |
|---|---|---|---|---|
| | (Expressed in thousands, except per share amounts) | | | |
| **Revenues:** | | | | |
| Oil and gas | $ 274,044 | $ 250,479 | $ 528,106 | $ 485,130 |
| Other | 520 | 218 | 13,610 | 700 |
| Total | 274,564 | 250,697 | 541,716 | 485,830 |
| **Operating Costs and Expenses:** | | | | |
| Lease operating | 33,464 | 22,864 | 62,185 | 46,333 |
| General and administrative | 18,320 | 14,674 | 37,045 | 29,843 |
| Exploration | 3,319 | 4,836 | 14,498 | 13,290 |
| Dry hole and impairment | 6,502 | 5,027 | 53,857 | 7,423 |
| Depreciation, depletion and amortization | 67,923 | 66,210 | 138,381 | 129,209 |
| Production and other taxes | 14,190 | 10,009 | 25,366 | 17,759 |
| Transportation and other | 4,409 | 4,760 | 10,248 | 9,642 |
| Total | 148,127 | 128,380 | 341,580 | 253,499 |
| **Operating Income** | 126,437 | 122,317 | 200,136 | 232,331 |
| **Interest:** | | | | |
| Charges | (13,850) | (6,627) | (24,061) | (16,071) |
| Income | 1,369 | 86 | 2,186 | 204 |
| Capitalized | 2,713 | 3,468 | 4,910 | 8,016 |
| **Loss on debt extinguishment** | | (10,893) | | (10,893) |
| **Foreign Currency Transaction Gain (Loss)** | (8) | (1) | 2 | (3) |
| **Income From Continuing Operations Before Taxes** | 116,661 | 108,350 | 183,173 | 213,584 |
| **Income Tax Expense** | (42,683) | (41,270) | (69,686) | (79,803) |
| **Income From Continuing Operations** | 73,978 | 67,080 | 113,487 | 133,781 |
| **Income (Loss) from Discontinued Operations, net of tax** | 29,461 | (1,891) | 49,188 | 3,048 |
| **Net Income** | $ 103,439 | $ 65,189 | $ 162,675 | $ 136,829 |
| **Earnings per Common Share:** | | | | |
| Basic | | | | |
| Income from continuing operations | $ 1.23 | $ 1.05 | $ 1.83 | $ 2.10 |
| | 0.48 | (0.03) | 0.80 | 0.05 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Income (loss) from discontinued operations, net of tax | | | | | | | | |
| Net income | $ | 1.71 | $ | 1.02 | $ | 2.63 | $ | 2.15 |
| | | | | | | | | |
| Diluted | | | | | | | | |
| Income from continuing operations | $ | 1.22 | $ | 1.04 | $ | 1.82 | $ | 2.08 |
| Income (loss) from discontinued operations, net of tax | | 0.48 | | (0.03) | | 0.78 | | 0.05 |
| Net income | $ | 1.70 | $ | 1.01 | $ | 2.60 | $ | 2.13 |
| | | | | | | | | |
| **Dividends per Common Share** | $ | 0.0625 | $ | 0.05 | $ | 0.125 | $ | 0.10 |

See accompanying notes to consolidated financial statements.

**POGO PRODUCING COMPANY AND SUBSIDIARIES**

**Consolidated Balance Sheets (Unaudited)**

| | June 30, 2005 | December 31, 2004 |
|---|---|---|
| | (Expressed in thousands, except share amounts) | |
| **Assets** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 242,631 | $ 86,456 |
| Accounts receivable | 115,120 | 120,466 |
| Other receivables | 17,301 | 20,875 |
| Federal income tax receivable | 3,164 | 10,708 |
| Inventories - tubulars | 14,521 | 9,112 |
| Price hedge contracts | | 6,722 |
| Assets from discontinued operations | 89,238 | 187,084 |
| Other | 2,198 | 3,987 |
| Total current assets | 484,173 | 445,410 |
| | | |
| **Property and Equipment:** | | |
| | | |
| Oil and gas, on the basis of successful efforts accounting | | |
| Proved properties | 4,117,637 | 4,003,332 |
| Unevaluated properties | 92,955 | 76,890 |
| Other, at cost | 33,496 | 28,656 |
| | 4,244,088 | 4,108,878 |
| Accumulated depreciation, depletion and amortization | | |
| Oil and gas | (1,686,575) | (1,551,502) |
| Other | (21,412) | (19,194) |
| | (1,707,987) | (1,570,696) |
| Property and equipment, net | 2,536,101 | 2,538,182 |
| | | |
| **Other Assets:** | | |
| Assets from discontinued operations | 477,059 | 480,097 |
| Other | 17,904 | 17,420 |
| | 494,963 | 497,517 |
| | | |
| | $ 3,515,237 | $ 3,481,109 |

See accompanying notes to consolidated financial statements.

**POGO PRODUCING COMPANY AND SUBSIDIARIES**

**Consolidated Balance Sheets (Unaudited)**

| | June 30, 2005 | December 31, 2004 |
|---|---|---|
| | (Expressed in thousands, except share amounts) | |
| **Liabilities and Shareholders Equity** | | |
| **Current Liabilities:** | | |
| Accounts payable - operating activities | $ 73,915 | $ 62,156 |
| Accounts payable - investing activities | 33,284 | 86,582 |
| Income taxes payable | 865 | 131 |
| Accrued interest payable | 9,387 | 4,550 |
| Accrued payroll and related benefits | 3,710 | 3,566 |
| Price hedge contracts | 11,503 | |
| Deferred income tax | 839 | 4,919 |
| Liabilities from discontinued operations | 130,922 | 109,928 |
| Other | 9,816 | 8,187 |
| Total current liabilities | 274,241 | 280,019 |
| **Long-Term Debt** | 880,354 | 755,000 |
| **Deferred Income Tax** | 524,236 | 536,823 |
| **Price Hedge Contracts** | 4,975 | 2,119 |
| **Asset Retirement Obligation** | 71,457 | 74,046 |
| **Other Liabilities and Deferred Credits** | 20,891 | 19,248 |
| **Liabilities from discontinued operations** | 82,950 | 85,959 |
| Total liabilities | 1,859,104 | 1,753,214 |
| **Commitments and Contingencies** | | |
| **Shareholders Equity:** | | |
| Preferred stock, $1 par; 4,000,000 shares authorized | | |
| Common stock, $1 par; 200,000,000 shares authorized, 64,749,340 and 64,580,639 shares issued, respectively | 64,749 | 64,581 |
| Additional capital | 950,483 | 943,690 |
| Retained earnings | 883,611 | 728,723 |
| Deferred compensation | (8,833) | (9,954) |
| Accumulated other comprehensive income (loss) | (10,492) | 2,565 |
| Treasury stock (4,808,259 and 55,359 shares, respectively), at cost | (223,385) | (1,710) |
| Total shareholders equity | 1,656,133 | 1,727,895 |
| | $ 3,515,237 | $ 3,481,109 |

See accompanying notes to consolidated financial statements.

3

**POGO PRODUCING COMPANY AND SUBSIDIARIES**

**Condensed Consolidated Statements of Cash Flows (Unaudited)**

| | Six Months Ended June 30, 2005 | Six Months Ended June 30, 2004 |
|---|---|---|
| | (Expressed in thousands) | |
| Cash Flows from Operating Activities: | | |
| Cash received from customers | $ 571,207 | $ 492,178 |
| Operating, exploration, and general and administrative expenses paid | (151,942) | (108,930) |
| Interest paid | (18,550) | (21,499) |
| Income taxes paid | (72,083) | (81,177) |
| Other | 3,820 | 3,485 |
| Cash provided by continuing operations | 332,452 | 284,057 |
| Cash provided by discontinued operations | 104,881 | 64,200 |
| Net cash provided by operating activities | 437,333 | 348,257 |
| | | |
| Cash Flows from Investing Activities: | | |
| Capital expenditures | (207,965) | (124,855) |
| Purchase of properties | (35,141) | (42,996) |
| Sale of current investments | 122,250 | |
| Purchase of current investments | (16,750) | |
| Proceeds from the sale of properties and companies | 7,837 | 269 |
| Cash used in continuing operations | (129,769) | (167,582) |
| Cash used in discontinued operations | (48,103) | (76,805) |
| Net cash used in investing activities | (177,872) | (244,387) |
| | | |
| Cash Flows from Financing Activities: | | |
| Borrowings under senior debt agreements | 1,165,000 | 550,000 |
| Payments under senior debt agreements | (1,337,000) | (494,000) |
| Proceeds from 2015 Notes | 297,303 | |
| Redemption of 2009 Notes | | (157,782) |
| Purchase of Company stock | (221,675) | |
| Payments of cash dividends on common stock | (7,787) | (6,385) |
| Payments from (to) discontinued operations | 109,560 | (20,782) |
| Payment of debt issue costs | (3,205) | |
| Proceeds from exercise of stock options | 4,264 | 3,260 |
| Cash provided by (used in) continuing operations | 6,460 | (125,689) |
| Cash provided by (used in) discontinued operations | (109,560) | 20,782 |
| Net cash used in financing activities | (103,100) | (104,907) |
| Effect of exchange rate changes on cash | (186) | 378 |
| Net (decrease) increase in cash and cash equivalents | 156,175 | (659) |
| Cash and cash equivalents from continuing operations, beginning of the year | 33,488 | 55,759 |
| Cash and cash equivalents from discontinued operations, beginning of the year | 52,968 | 48,715 |
| Cash and cash equivalents at the end of the period | $ 242,631 | $ 103,815 |
| | | |
| Reconciliation of net income to net cash provided by operating activities: | | |
| Net income | $ 162,675 | $ 136,829 |
| Adjustments to reconcile net income to net cash provided by operating activities - Income from discontinued operations, net of tax | (49,188) | (3,048) |
| Gains from the sales of properties | (250) | (268) |
| Depreciation, depletion and amortization | 138,381 | 129,209 |
| Dry hole and impairment | 53,857 | 7,423 |

| | | | | |
|---|---|---|---|---|
| Interest capitalized | | (4,910) | | (8,016) |
| Price hedge contracts | | 993 | | |
| Other | | 5,831 | | 14,858 |
| Deferred income taxes | | (9,057) | | 4,898 |
| Change in operating assets and liabilities | | 34,120 | | 2,172 |
| Net cash provided by continuing operating activities | | 332,452 | | 284,057 |
| Net cash provided by discontinued operating activities | | 104,881 | | 64,200 |
| Net cash provided by operating activities | $ | 437,333 | $ | 348,257 |

See accompanying notes to consolidated financial statements.

**POGO PRODUCING COMPANY AND SUBSIDIARIES**

**Consolidated Statements of Shareholders Equity (Unaudited)**

| | For the Six Months Ended June 30, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | | | 2004 | | | | | |
| | Shareholders | | | | Shareholders | | | | | |
| | Equity | | Comprehensive | | Equity | | Net income | | 3,460 | 3,460 |
| Balances at September 30, 2006 | $ | $ | 78 | $ | 30,457 | $ | 3,408 | $ | $ 33,943 | |

See accompanying notes to the consolidated financial statements.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years Ended September 30, 2006 and 2005

(In thousands)

| | 2006 | 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 3,460 | $ 2,614 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation, amortization and loss on disposals | 420 | 321 |
| Deferred income taxes | 1,617 | 281 |
| Equity in income from asset management joint venture | (331) | (218) |
| Minority interest | 71 | |
| Amortization of stock option expense for consultants | 29 | |
| Unrealized investment gain from INTL Consilium managed funds | (210) | (250) |
| Changes in operating assets and liabilities: | | |
| Receivable from brokers, dealers and clearing organization | (4,514) | 4,090 |
| Receivable from customers | 174 | (3,271) |
| Financial instruments owned, at fair value | (13,244) | (52,571) |
| Physical commodities inventory, at cost | (15,306) | |
| Prepaid income taxes | (2,841) | |
| Other assets | 229 | (62) |
| Accounts payable and accrued expenses | 772 | (298) |
| Financial instruments sold, not yet purchased, at fair value | 18,803 | 55,147 |
| Payable to brokers, dealers and clearing organization | 5,547 | (7,730) |
| Payable to customers | (411) | (1,459) |
| Accrued compensation and benefits | 2,107 | (43) |
| Income taxes payable | (311) | 1,120 |
| Other liabilities | (41) | 259 |
| Net cash used in operating activities | (3,980) | (2,070) |
| Cash flows from investing activities: | | |
| Distribution of earnings from asset management joint venture | 296 | |
| Cash on consolidation of INTL Consilium | 421 | |
| Payments related to acquisition of INTL Global Currencies | (1,836) | (1,562) |
| Investment in INTL Consilium managed fund | (1,005) | |
| Investment withdrawals from INTL Consilium managed fund | 3,368 | |
| Purchase of fixed assets, leasehold improvements and intangible assets | (586) | (303) |
| Net cash provided by (used in) investing activities | 658 | (1,865) |
| Cash flows from financing activities: | | |
| Issuance of convertible subordinated notes payable, net | 25,401 | |
| Payable to lenders under loans and overdrafts | (6,313) | 2,400 |
| Exercise of stock options | 2,021 | 693 |
| Net cash provided by financing activities | 21,109 | 3,093 |
| Net increase (decrease) in cash and cash equivalents | 17,787 | (842) |
| Cash and cash equivalents at beginning of period | 20,242 | 21,084 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 38,029 | $ 20,242 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $ 2,020 | $ 1,315 |
| Income taxes paid | $ 3,234 | $ 139 |

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years Ended September 30, 2006 and 2005

(In thousands)

| | 2006 | 2005 |
|---|---|---|
| Supplemental disclosure of noncash investing activities: | | |
| Assumption of trust certificates, at cost, with related financial instruments sold, not yet purchased, at market value and receivable from customers | $ | $ 24,539 |
| Partial release of trust certificates, at cost, with related financial instruments sold, not yet purchased, at market value and receivable from customers | $ 1,441 | $ |
| Additional goodwill in connection with acquisition of INTL Global Currencies | $ 275 | $ 3,628 |
| Estimated beginning fair value of assets and (liabilities) in consolidation of INTL Consilium, LLC (unaudited): | | |
| Assets acquired | $ 1,160 | $ |
| Liabilities assumed | (138) | |
| Minority owners interest | (310) | |
| Total net assets acquired | $ 712 | $ |
| Supplemental disclosure of noncash financing activities: | | |
| Retirement of 4,992 common shares held in treasury | $ | $ 37 |

See accompanying notes to the consolidated financial statements.

F-6

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

## (1) Summary of Significant Accounting Policies

### *(a) Principles of Consolidation*

The consolidated financial statements include the accounts of International Assets Holding Corporation, its subsidiaries and a variable interest entity of which it is the primary beneficiary ( the Company ). The Company s subsidiaries are INTL Trading, Inc. ( INTL Trading ), INTL Assets, Inc. ( INTL Assets ), INTL Holding (U.K.) Limited ( INTL Holding (U.K.) ), INTL Global Currencies Limited ( INTL Global Currencies ), INTL Commodities, Inc. ( INTL Commodities ), INTL Capital Limited ( INTL Capital ) and IAHC (Bermuda) Ltd. The accounts of INTL Consilium, LLC ( INTL Consilium ), which has been treated as a variable interest entity and in which International Assets Holding Corporation has been the primary beneficiary since August 1, 2006, are also included in the consolidated financial statements.

All significant intercompany balances and transactions have been eliminated in consolidation.

INTL Trading is registered as a broker-dealer under the Securities Exchange Act of 1934. INTL Trading clears its securities transactions through the Broadcort division of Merrill Lynch, Pierce, Fenner & Smith, Inc. ( Broadcort ) on a fully disclosed basis.

INTL Assets holds most of the U.S. physical assets of the Company.

INTL Holding (U.K.) is a U.K. holding company that owns 100% of INTL Global Currencies. INTL Global Currencies operates a foreign exchange trading business. Both INTL Holding (U.K.) and INTL Global Currencies are designated as U.S. dollar denominated companies under the laws of the United Kingdom. Accordingly, the functional currency for these companies is the U.S. dollar.

International Assets Holding Corporation engages in foreign exchange trading, trade finance and structured financial transactions.

INTL Commodities was formed in September 2005 to own and operate the Company s commodities trading business. International Assets Holding Corporation transferred this business to INTL Commodities during the first half of fiscal 2006.

INTL Capital is a Dubai limited company formed in September 2006 as an asset management firm to invest in global trade finance-related assets.

The Company owns a 50.1% limited liability company interest in INTL Consilium, an investment advisory firm that focuses on the emerging market asset class. INTL Consilium was accounted for using the equity method of accounting until July 31, 2006 (see notes 1(n) and 4 for more information). The Company has consolidated INTL Consilium as of August 1, 2006 based on the consolidation requirements of the Financial Accounting Standards Board ( FASB ) Interpretation No. 46(R) ( FIN 46(R) )(see note 3 for further information).

### *(b) Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the period. Actual results could differ from those estimates.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

***(c) Cash and Cash Equivalents***

Cash and cash equivalents consist of cash and cash deposits with brokers, dealers and the Company s clearing organization. All cash and cash equivalents deposited with brokers, dealers and clearing organization support the Company s trading activities, and are subject to contractual restrictions. Cash deposits with clearing organization consist of cash, foreign currency and money market funds stated at cost, which approximates fair value. The money market funds earn interest at varying rates on a daily basis. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. The Company is subject to concentration of credit risk because a substantial portion of the Company s cash and cash equivalents (approximately $7,811,000 as of September 30, 2006) are maintained at the Company s clearing organization.

***(d) Foreign Currency***

The value of a foreign currency is converted into its U.S. dollar equivalent at the foreign exchange rate in effect at the close of business as of September 30, 2006 and 2005. For foreign currency transactions completed during the fiscal year, the Company utilizes the foreign exchange rate in effect at the time of the transaction.

***(e) Financial Instruments and Investments***

Financial instruments owned, at fair value and Financial instruments sold, not yet purchased, at fair value consist of financial instruments carried at fair value or amounts that approximate fair value, with related unrealized gains or losses recognized in the Company s results of operations. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

*Cash trading instruments* Fair values of cash trading instruments are generally obtained from quoted market prices in active markets, broker or dealer price quotations, or alternative pricing sources with reasonable levels of transparency. The types of instruments valued in this manner include common stock, American Depositary Receipts, sovereign government, provincial and corporate debt obligations and physical commodities. The value of a foreign security is determined in the functional currency of the principal exchange on which the security is traded, which value is then converted into its U.S. dollar equivalent at the foreign exchange rate in effect following the close of such exchange. Certain cash trading instruments trade infrequently and, therefore, have little price transparency. Such instruments may include commercial paper and similar debt instruments. The Company values these instruments by reference to the interest rate spread sought on the same or equivalent instruments by other brokers or dealers active in those markets. Cash trading instruments owned are marked to bid prices and instruments sold but not yet purchased are marked to offer prices.

*Derivative contracts* Derivative contracts consist of exchange-traded and over-the-counter ( OTC ) derivatives. Fair values of exchange-traded derivatives are generally determined from quoted market prices. OTC derivatives are valued using valuation models. The valuation models used to derive the fair values of OTC derivatives require inputs including contractual terms, market prices, yield curves and measurements of volatility. The Company uses similar models to value similar instruments. Where possible, the Company verifies the values produced by pricing models by comparing them to market transactions. Inputs may involve judgment where market prices are not readily available.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

*Investments* The Company has made an investment in a hedge fund sponsored by INTL Consilium. This investment is valued at fiscal year-end at the net asset value provided by the fund s administrator as of the date of valuation.

***(f) Revenue Recognition***

The revenues of the Company are derived from realized and unrealized trading income in securities, derivative instruments, commodities and foreign currencies purchased or sold for the Company s account. Realized and unrealized trading income (net dealer inventory and investment gains) are recorded on a trade date basis. Commissions and related clearing expenses are recorded on a trade-date basis as securities transactions occur. Securities owned and securities sold, not yet purchased are stated at fair value with related changes in unrealized appreciation or depreciation reflected in net dealer inventory and investment gains. Interest income is recorded on the accrual basis and dividend income is recognized on the ex-dividend date.

***(g) Revenues Reported on Gross Basis***

In accordance with the guidelines provided in Emerging Issues Task Force ( EITF ) Issue No. 99-19, the Company has determined that revenues of the Company s base metals trading business, which commenced in October 2005, should be reported on a gross basis, with the corresponding cost of sales shown separately. This matter is discussed further in note 24, under the sub-heading Commodities Trading .

***(h) Physical commodities inventory***

Physical commodities inventory is valued in accordance with ARB 43 at the lower of cost or fair market value, determined using the weighted average price method.

***(i) Depreciation and Amortization***

Depreciation of fixed assets is calculated using the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the term of the lease or the estimated period of benefit to be received from the assets, which range from three to seven years.

***(j) Income Taxes***

The Company files consolidated Federal income tax returns. The Company files consolidated state income tax returns in those states in which the Company meets the consolidation requirements and files separately in those states in which consolidation is not applicable.

The Company complies with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach to financial reporting for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is

recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to an amount that, in the opinion of management, is more likely than not to be realized.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

***(k) Stock-Based Employee Compensation***

In October 1995, the FASB issued SFAS No. 123, *Accounting for Stock-Based Compensation*, which generally permits entities to recognize as expense over the vesting period the fair value of all stock-based awards calculated on the date of grant. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of Accounting Principles Board (APB) Opinion No. 25, which provides that compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price and provides for pro forma disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123.

If the Company had determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company s net income and earnings per share would be as reflected in the pro forma amounts indicated below:

**(In thousands, except per share amounts)**

| | | **2006** | **2005** |
|---|---|---|---|
| Net income | As reported | $ 3,460 | $ 2,614 |
| Pro forma option compensation expense | Pro forma | $ (537) | $ (462) |
| Net income | Pro forma | $ 2,923 | $ 2,152 |
| Basic earnings per share | As reported | $ 0.45 | $ 0.36 |
| | Pro forma | $ 0.38 | $ 0.29 |
| Diluted earnings per share | As reported | $ 0.41 | $ 0.33 |
| | Pro forma | $ 0.35 | $ 0.27 |

***(l) Basic and Diluted Earnings Per Share***

Basic earnings per share have been computed by dividing net income by the weighted average number of common shares outstanding.

The Company has complied with SFAS No. 128, *Earnings per Share*, which requires the use of the if-converted method when convertible securities are present (see note 2).

Options to purchase 10,000 shares and 101,250 shares of common stock were excluded from the calculation of diluted earnings per share for the years ended September 30, 2006 and 2005, respectively, because the exercise prices of these options exceeded the average market price of the common stock for the period (anti-dilutive).

Convertible subordinated notes payable which are convertible into 1,058,824 common shares were not included in the calculation of diluted earnings per share for the weighted period September 21, 2006 through September 30, 2006 because their incremental inclusion was antidilutive.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(In thousands, except per share amounts)**

| | **2006** | **2005** |
|---|---|---|
| Diluted earnings per share | | |
| Numerator: | | |
| Net income | $ 3,460 | $ 2,614 |
| Denominator: | | |
| Weighted average number of: | | |
| Common shares outstanding | 7,637 | 7,303 |
| Dilutive potential common shares outstanding | 751 | 721 |
| | 8,388 | 8,024 |
| Diluted earnings per share | $ 0.41 | $ 0.33 |

***(m) Effects of Recently Issued Accounting Standards***

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123(R) ). This statement requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award in its financial statements. It also requires the cost to be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). SFAS No. 123(R) replaces SFAS No. 123 and supersedes APB Opinion No. 25, and its related interpretations. Small-business issuers (such as the Company) must apply SFAS No. 123(R) for annual periods beginning after December 15, 2005. In the Company s case, this will be the fiscal year commencing on October 1, 2006.

The Company currently uses the Black-Scholes option pricing model to measure the fair value of stock options granted to employees. While SFAS No. 123(R) permits entities to continue to use such a model, it also permits the use of a lattice model. The Company expects to use a lattice model upon adoption of SFAS No. 123(R) to measure the fair value of stock options.

The adoption of this statement will have the effect of reducing net income and income per share as compared to what would be reported under the current requirements. These future amounts cannot be precisely estimated because they depend on, among other things, the number of options issued in the future and, accordingly, the Company believes that the adoption of SFAS No. 123(R) may have a material effect on the Company s consolidated financial statements, in the form of additional compensation expense. The pro forma numbers disclosed in paragraph 1(k) above provide an indication of the past effect on earnings per share of share-based payment, though based on the Black-Scholes option pricing model.

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes.* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* . This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The interpretation is effective for fiscal years beginning after December 15, 2006.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. SFAS No. 157 simplifies and codifies related guidance within GAAP, but does not require any new fair value measurements. The guidance in SFAS No. 157 applies to derivatives and other financial instruments measured at estimated fair value under SFAS No. 133 and related pronouncements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management does not expect the adoption of SFAS No. 157 to have a significant effect on the Company s consolidated financial position or results of operations.

***(n) Investment in Joint Venture***

The investment in the Company s asset management joint venture, INTL Consilium, was accounted for under the equity method of accounting until July 31, 2006. Under this method, the Company s investment in INTL Consilium was recorded at cost and adjusted by the Company s share of the contributions, distributions and undistributed earnings or losses of the joint venture. On August 1, 2006 the Company received a repayment of the portion of capital that had entitled the Company to a three-year liquidation preference and advanced a $1,000,000 subordinated loan to INTL Consilium. Following the guidelines set out in FIN 46(R), INTL Consilium has been treated as a variable interest entity of which the Company is the primary beneficiary. INTL Consilium is accordingly required to be consolidated from August 1, 2006 onward.

***(o) Variable Interest Entities***

The Company consolidates variable interest entities in which it is the primary beneficiary, in accordance with the guidelines set out in FIN 46 (R). For further information see note 3 below.

***(p) Goodwill and Other Intangible Assets***

Goodwill represents the excess of cost over fair value of assets of the business acquired. The Company adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets,* on July 9, 2004 with the acquisition of INTL Global Currencies. Pursuant to SFAS No. 142, goodwill acquired in a purchased business combination and determined to have an indefinite useful life is not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142.

Intangible assets are amortized over their estimated useful lives of three years. Residual value is presumed to be zero, subject to certain exceptions. Intangible assets are reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*, whenever events or circumstances indicate that the carrying amount may not be recoverable.

***(q) Reclassification***

Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(2) Issuance of Convertible Subordinated Notes and Related Debt Issuance Costs**

On September 20, 2006 the Company issued $27.0 million in aggregate principal amount of the Company s senior subordinated convertible notes due 2011 ( the Notes ). The Company expects to use the proceeds from the sale of the Notes to repay debt and for general corporate purposes. The Notes are general unsecured obligations of the Company.

The Notes bear interest at the rate of 7.625% per annum, payable quarterly in arrears commencing on October 1, 2006.

The Notes are convertible by the holders at any time following their issuance into shares of common stock of the Company, at an initial conversion price of $25.50 per share. The conversion price is subject to certain adjustments set forth in the Notes.

The maturity date of the Notes is the fifth anniversary of the issuance of the Notes.

The Company may, at its option, redeem the Notes for cash on March 11, 2010, at a redemption price equal to 110% of the Conversion Amount (the principal amount of the Notes, together with accrued interest and any late charges), subject to certain conditions set forth in the Notes.

If the ratio of the Company s consolidated earnings before interest, taxes, depreciation and amortization, as defined in the Notes, to the Company s consolidated cash interest expense (the Consolidated Interest Coverage Ratio ) is less than 2.75 for the 12 month period ending on December 31, 2009, the holders of the Notes will have the option to require the Company to redeem all or any portion of the Notes at a redemption price equal to 100% of the Conversion Amount to be redeemed.

If, at any time after March 22, 2008, the dollar-volume weighted average price of the common stock exceeds, for any twenty out of thirty consecutive trading days, 150% of the conversion price of the Notes, the Company will have the right to require the holders of the Notes to convert all or any portion of the Notes into shares of Common Stock at the then-applicable conversion price.

Commencing with the fiscal quarter ending on September 30, 2007, in the event that the Consolidated Interest Coverage Ratio for the 12 months preceding the end of any fiscal quarter is less than 2.0, the interest rate on the Notes will be increased by 2.0% to 9.625% per annum, effective as of the first day of the following fiscal quarter.

Debt issuance costs of $1,608,000 were incurred in connection with the issuance of the Notes. The total debt issuance costs will be amortized over the life of the Notes (through September 20, 2011) and charged to interest expense. Total interest amortization expense for the debt issuance costs for 2006 is $9,000.

The Company has entered into a separate Registration Rights Agreement with the holders of the Notes, under which the Company was required to file with the U.S. Securities and Exchange Commission ( the SEC ) a Registration Statement on Form S-3 within a specified period of time. The Registration Statement was declared effective by the SEC on October 24, 2006. The Company is now required, under the Registration Rights Agreement, to maintain the effectiveness of the Registration Statement, failing which it could become liable to pay holders of the Notes liquidated damages of 1% of the value of the Notes upon a failure to maintain effectiveness of the Registration Statement, plus a further 1% for every 30 days that it remains ineffective thereafter, up to an aggregate maximum of 10% of the value of the Notes.

The Company has analyzed the Notes in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* and EITF Issue No. 05-2, *The Meaning of Conventional Convertible Debt Instrument in Issue No. 00-19* to determine whether the

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

hybrid contract that is represented by the Notes has an embedded derivative that should be separately accounted for. The Company s conclusion is that the conversion feature embedded in the Notes may be classified as equity and is therefore excluded from the scope of SFAS No. 133 and does not need to be accounted for separately from its host contract.

The Company has further analyzed the Notes in accordance with EITF Issue No. 05-4, *The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument subject to EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* . This addresses instances in which financial instruments, such as convertible notes, are issued with a related registration rights agreement that contains a liquidated damages clause. A registration rights agreement signed by the Company in September 2006 required the Company to use its best efforts to file a registration statement for the resale of the shares of stock underlying the Notes, to have the registration statement declared effective within a specified period, and to maintain its effectiveness by meeting all SEC filing and other requirements; failing which the Company would be liable to pay certain specified damages to the investors.

The Company s conclusion is that the liquidated damages clause in the registration rights agreement should be valued separately from the Notes, as a liability, in accordance with the View C expressed in EITF Issue No. 05-4. This has given rise to the recording of a liability of $141,000 and a corresponding discount to the value of the Notes, of which $1,000 was amortized and charged to interest expense for the fiscal year ended September 30, 2006.

**(3) Variable Interest Entities**

FIN 46(R), *Consolidation of Variable Interest Entities: an Interpretation of ARB No. 51*, expands upon the consolidation guidance contained in ARB No. 51, which views a majority voting interest as the primary criterion in determining whether one entity has a controlling financial interest in another entity. FIN 46(R) provides for consolidation of certain entities in which the reporting entity does not have a controlling financial interest as defined in ARB No. 51. If an analysis in terms of FIN 46(R) determines that one entity is the primary beneficiary of the variable interests in another entity (the variable interest entity, or VIE ), the primary beneficiary is required to consolidate the variable interest entity.

On May 11, 2004, the Company entered into an agreement with Consilium Investment Capital, Inc. ( CIC ) of Fort Lauderdale, Florida to form INTL Consilium. INTL Consilium is an investment management firm which primarily provides investment advice with respect to emerging market securities. In June 2004 the Company made a capital contribution of $500,000 and CIC contributed $100,000 to INTL Consilium. The Company s total capital contribution was allocated as $100,000 share capital and $400,000 excess capital. The excess capital contribution was made by the Company in recognition of the asset management skills and relationships contributed by CIC. The excess capital contribution had a liquidation preference of three years. The Company received 50.1% of the shares of INTL Consilium and was permitted to appoint two of the four directors, the remaining two directors being the principals of CIC. No individual director has a deciding vote in the event of a deadlock. The two principals of CIC actively manage the business. On August 1, 2006 the $400,000 excess capital contribution was repaid by INTL Consilium to the Company and the Company made a subordinated loan to INTL Consilium of $1,000,000, bearing interest at 5.36%.

An analysis in terms of FIN 46(R) in 2004 determined that INTL Consilium was not initially a variable interest entity. The Company accordingly accounted for its interest in INTL Consilium on the equity method until July 31, 2006. The Company determined that the repayment of excess capital, the termination of the related liquidation preference and the advance of a subordinated loan to INTL

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

Consilium combined to make INTL Consilium a variable interest entity and the Company its primary beneficiary. With effect from August 1, 2006 the Company has consolidated INTL Consilium as a variable interest entity.

The Company accounted for one VIE during the fiscal year ended September 30, 2005 ( 2005 VIE ). The Company consolidated the 2005 VIE, which involved an investment in a hedge fund (through an offshore feeder fund) managed by INTL Consilium, for the quarters ended December 31, 2004, March 31, 2005 and June 30, 2005. In the quarter ended September 30, 2005 the Company withdrew its investment from the offshore feeder fund and placed the investment in a second, larger, domestic (U.S.) feeder fund managed by INTL Consilium. At September 30, 2005 the Company had an interest of approximately 3% in, and was not the primary beneficiary of, this domestic feeder fund. Accordingly, there was no basis for consolidation of the domestic feeder fund and there was no minority owners interest recognized in the Consolidated Balance Sheet at September 30, 2005. The amount of minority owners interest in the income of consolidated entity shown in the Consolidated Statement of Operations for the 2005 fiscal year relates to the period during which the Company consolidated the results of the 2005 VIE.

**(4) Investment in INTL Consilium**

As discussed in note 3, the Company accounted for its investment in INTL Consilium under the equity method prior to August 1, 2006. For the fiscal years ended September 30, 2006 and 2005 the Company has recorded income of $331,000 and $217,000, respectively, for its 50.1% share of INTL Consilium s income and loss for the two periods. The $331,000 of income for 2006 is based on the ten month period from October 1, 2005 through July 31, 2006. Below are the unaudited condensed statement of operations and condensed balance sheet of INTL Consilium for the year ending September 30, 2005.

F-15

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**INTL Consilium, LLC**

Condensed Statement of Operations

For the year ended September 30, 2005

(Unaudited)

**(In thousands)**

| | **2005** |
|---|---|
| Revenues: | |
| Management and investment advisory fees | $ 1,521 |
| Interest income | 4 |
| Other | 27 |
| Total revenues | 1,552 |
| Non-interest expenses: | |
| Compensation and benefits | 771 |
| Occupancy and equipment rental | 46 |
| Professional fees | 87 |
| Depreciation | 11 |
| Business development | 75 |
| Insurance | 53 |
| Other | 72 |
| Total non-interest expenses | 1,115 |
| Net income | $ 437 |

F-16

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**INTL Consilium, LLC**

Condensed Balance Sheet

September 30, 2005

(Unaudited)

**(In thousands)**

| | **2005** |
|---|---|
| **Assets** | |
| Cash | $ 214 |
| Management and investment advisory fees receivable | 574 |
| Investment in INTL Consilium sponsored fund | 297 |
| Property and equipment, net | 27 |
| Other assets | 34 |
| Total assets | $ 1,146 |
| **Liabilities and Members Equity** | |
| Liabilities | |
| Accounts payable | $ 35 |
| Accrued compensation and benefits | 158 |
| Total liabilities | 193 |
| Members equity: | 953 |
| Total liabilities and members equity | $ 1,146 |

**(5) Investment in INTL Consilium Managed Fund**

As of September 30, 2006 and 2005 the Company had investments valued at $1,246,000 and $3,270,000 in two hedge funds managed by INTL Consilium. The Company owns a 50.1% interest in INTL Consilium.

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(6) Goodwill**

The Company acquired the foreign exchange business of INTL Global Currencies in 2004. The purchase price paid by the Company for the acquisition exceeded the net asset value received by $2,489,000. Of this amount, $350,000 was allocated to intangible assets and the balance of $2,138,000 was treated as goodwill. The Company has accrued additional goodwill of $4,190,000 under the earn-out provisions of the purchase agreement. As of September 30, 2006, the Company had paid $3,399,000 of the additional goodwill. The balance of the additional goodwill accrual of $791,000 is reported as deferred acquisition consideration payable in the Company s consolidated balance sheets.

The goodwill related to the INTL Global Currencies acquisition is as follows:

**(In thousands)**

| | September 30, 2006 | September 30, 2005 |
|---|---|---|
| Cash premium paid to sellers | $ 1,000 | $ 1,000 |
| Cash paid for net assets received | 3,577 | 3,577 |
| Negotiation differences for fixed assets and stamp duty | (50) | (50) |
| Legal and accounting fees | 66 | 66 |
| Value of 150,000 common shares at $9.81 per share | 1,472 | 1,472 |
| Total payments of cash and shares | 6,065 | 6,065 |
| Less: Fair value of net assets received | 3,577 | 3,577 |
| Less: Intangible assets identified by independent valuation | 350 | 350 |
| Initial goodwill | 2,138 | 2,138 |
| Additional goodwill under earnout based on foreign exchange revenues | 4,190 | 3,916 |
| Total goodwill | $ 6,328 | $ 6,054 |

The additional goodwill is calculated for each period as each earn-out payment is earned and an adjustment is recorded to goodwill. The first five earn-out installments totaling $3,162,000 have been paid. The sixth earn-out installment of $400,000 was paid November 29, 2006. One additional minimum payment of $391,000 each is due on or by March 1, 2007, with the maximum amount due being $400,000. Furthermore, the Company was required to pay $237,000 on August 29, 2006, being 10% of revenues exceeding $10,000,000 for the twelve month period ended June 30, 2006. The Company will be required to make an additional payment equal to 10% of any revenues exceeding $5,000,000 for the six month period ending December 31, 2006.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(7) Intangible assets**

Intangible assets at September 30, 2006 and 2005 were constituted as follows:

**(In thousands)**

| | September 30, 2006 | September 30, 2005 |
|---|---|---|
| Noncompete agreement | $ 150 | 150 |
| Trade name | 100 | 100 |
| Customer base | 100 | 100 |
| Other costs | 17 | |
| Asset management contract | 153 | |
| Web site development costs | 20 | |
| Total intangible assets | 540 | 350 |
| Less: Amortization of intangible assets | 261 | 117 |
| Intangible assets, net | $ 279 | 233 |

**(8) Related Party Transactions**

One of the Company s principal shareholders has made an investment, valued at approximately $100,000,000 as of September 30, 2006, in a hedge fund managed by INTL Consilium. An executive of this shareholder is a director of the Company.

Two executive officers of the Company have individually made investments, either directly or indirectly, collectively valued at approximately $595,000, in a hedge fund managed by INTL Consilium.

F-19

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(9) Financial Instruments Owned and Financial Instruments Sold, Not Yet Purchased, at Fair Value**

Financial instruments owned and financial instruments sold, not yet purchased at September 30, 2006 and 2005 consisted of trading and investment securities at fair values as follows:

**(In thousands)**

| | **Owned** | **Sold, not yet purchased** |
|---|---|---|
| **September 30, 2006:** | | |
| Common stock and American Depository Receipts | $ 3,660 | $ 5,523 |
| Exchangeable foreign ordinary equities and American Depository Receipts | 46,597 | 46,747 |
| Corporate and municipal bonds | 6,133 | |
| Foreign government obligations | 1,368 | |
| Negotiable instruments (promissory notes) | 12,445 | |
| U.S. Treasury Bonds under total return swap transactions | 23,886 | |
| Options and futures | 14,392 | 13,801 |
| Commodities | | 19,414 |
| U.S. Government obligations | | 776 |
| Other investments | 25 | |
| | $ 84,620 | $ 110,147 |

**(In thousands)**

| | **Owned** | **Sold, not yet purchased** |
|---|---|---|
| **September 30, 2005:** | | |
| Common stock and American Depository Receipts | $ 2,638 | $ 4,155 |
| Exchangeable foreign ordinary equities and American Depository Receipts | 28,707 | 28,919 |
| Corporate and municipal bonds | 3,873 | 255 |
| Foreign government obligations | 1,183 | 2,479 |
| Negotiable instruments (promissory notes) | 7,777 | |
| U.S. Treasury Bonds under total return swap transactions | 24,558 | |
| Options and futures | 3,338 | 3,182 |
| Commodities | 23,823 | 28,451 |
| U.S. Government obligations | | 17 |
| Other investments | 37 | |
| | $ 71,376 | $ 92,016 |

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(10) Physical Commodities Inventory**

Physical commodities inventory is valued at the lower of cost or market value, determined using the weighted average price method. The value of the Company s inventory at September 30, 2006 was $15,306,000 at cost, which was lower than fair market value.

**(11) Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk**

The Company is party to certain financial instruments with off-balance sheet risk in the normal course of business as a registered securities broker-dealer and from its market making and proprietary trading in the foreign exchange and commodities trading business. The Company has sold financial instruments that it does not currently own and will therefore be obliged to purchase such financial instruments at a future date. The Company has recorded these obligations in the consolidated financial statements at September 30, 2006 at fair values of the related financial instruments (totaling $110,147,000). The Company will incur losses if the market value of the financial instruments increases subsequent to September 30, 2006. The total of $110,147,000 includes $13,801,000 for options and futures contracts, which represent a liability to the Company based on their fair values as of September 30, 2006.

Listed below is the fair value of trading-related derivatives as of September 30, 2006 and September 30, 2005. Assets represent net unrealized gains and liabilities represent net unrealized losses.

| (In thousands) | September 30, 2006 Assets | September 30, 2006 Liabilities | September 30, 2005 Assets | September 30, 2005 Liabilities |
|---|---|---|---|---|
| Interest Rate Derivatives | $ | $ 15 | $ 29 | $ |
| Foreign Exchange Derivates | 23 | | 17 | |
| Commodity Price Derivatives | 14,369 | 13,786 | 3,292 | 3,182 |
| Total | $ 14,392 | $ 13,801 | $ 3,338 | $ 3,182 |

Options and futures contracts held by the Company result from its customers market-making and proprietary trading activities in the commodities trading and foreign exchange business segments. The Company assists its commodities customers in protecting the value of their future production (precious or base metals) by selling them put options on an OTC basis. The Company also provides its commodities customers with sophisticated option products, including combinations of buying and selling puts and calls. The Company mitigates its risk by effecting offsetting OTC options with market counterparties or through the purchase or sale of commodities futures traded through the COMEX division of the New York Mercantile Exchange. The risk mitigation of offsetting options is not within the documented hedging designation requirements of SFAS No. 133.

These derivative contracts are traded along with cash transactions because of the integrated nature of the markets for such products. The Company manages the risks associated with derivatives on an aggregate basis along with the risks associated with its proprietary trading and market-making activities in cash instruments as part of its firm-wide risk management policies.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

In the normal course of business, the Company purchases and sells financial instruments and foreign currencies as either principal or agent on behalf of its customers. If either the customer or counterparty fails to perform, the Company may be required to discharge the obligations of the nonperforming party. In such circumstances, the Company may sustain a loss if the market value of the financial instrument or foreign currency is different from the contract value of the transaction.

The majority of the Company s transactions and, consequently, the concentration of its credit exposure is with customers, broker-dealers and other financial institutions. These activities primarily involve collateralized and uncollateralized arrangements and may result in credit exposure in the event that the counterparty fails to meet its contractual obligations. The Company s exposure to credit risk can be directly impacted by volatile financial markets, which may impair the ability of counterparties to satisfy their contractual obligations. The Company seeks to control its credit risk through a variety of reporting and control procedures, including establishing credit limits based upon a review of the counterparties financial condition and credit ratings. The Company monitors collateral levels on a daily basis for compliance with regulatory and internal guidelines and requests changes in collateral levels as appropriate.

**(12) Trust Certificates and Total Return Swap**

During the quarter ended December 31, 2004, the Company entered into a series of financial transactions (the Transactions ) with an unaffiliated financial institution in Latin America for a transaction fee. These Transactions involved three distinct and simultaneous steps:

a) the acquisition by the Company of beneficial interests ( Trust Interests ) in certain trusts (the Trusts ) in exchange for the assumption of a liability to deliver securities, at a transaction value of $29,740,000. This step did not require any prior purchase or delivery of securities by the Company. The Trusts were previously established by the financial institution to hold a variety of real estate assets;

b) the entry into a repurchase agreement under the terms of which the Company notionally repurchased these undelivered securities for cash, at a price of $29,740,000;

c) the entry into a total return swap ( TRS ) agreement.

    i) Under the TRS agreement the Company received, on a notional basis, the cash amount of $29,740,000 as collateral for the potential liability of the financial institution to the Company.

    ii) Receivables or payables arising from the TRS should leave the Company unaffected by any changes in the values of the Trust Interests or securities deliverable.

    iii) When the Transactions terminate in November 2007, the Company intends to sell the Trust Interests at their then prevailing market values. As part of the Transactions, the gain or loss arising from the change in market value of the Trust Interests will

be passed to the financial institution.

iv) The Company has obtained legal advice on the Transactions and believes that the TRS agreement has been structured in such a way as to fully offset any changes in the value of the Trust Interests against its liability to deliver certain securities to the financial institution.

The initial transaction value was $29,740,000. The Company has since sold Trust Interests for $6,642,000, the price at which they were acquired, and released a proportionate share of the securities referred to in b) above from the repurchase arrangement. The Company has obtained a valuation of the real estate assets underlying the trust certificates. This valuation has resulted in a valuation adjustment of $10,334,000 with an equal and offsetting receivable from customer recorded for $10,334,000. Accordingly, the trust certificates are carried by the Company at $12,764,000 ($29,740,000 less $6,642,000 less $10,334,000).

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

Under FIN 39 the nominal payment and receipt of an equal amount of cash as described in b) and c) i) above have a net effect of zero on the Company s cash position, represent transactions with a single counterparty and may therefore be offset. Under FIN 39 the asset of securities receivable under the repurchase agreement in b) may be offset against the collateral liability of the Company in c) ii), since they involve an asset and liability position with a single counterparty.

The net result is that the Company initially reported the effects of a) above as an increase in assets represented by the Trust Interests, and the assumption of a liability to deliver securities. Over time, as the values of the Trust Interests and securities deliverable change, the Company records equal and offsetting changes in the values of the TRS receivables or payables. Although the Transactions will temporarily increase the Company s assets and liabilities until termination, the Company expects that the only impact of the transactions on the Company s net cash flow will be the Company s receipt of fee revenue.

The total fees received and to be received on the Transactions, as well as the associated variable compensation payable, are spread on a straight-line basis over the terms of the Transactions. Non-refundable fees received but not yet recognized as revenue, amounting to $84,000, appear as a liability on the Consolidated Balance Sheets as at September 30, 2006 under Other liabilities . Non-recoverable costs incurred in connection with the Transactions but not yet recognized as expenses, amounting to $25,000, appear as an asset under Other assets at the same date.

**(13) Other revenues**

Other revenue is comprised of the following for the years ending September 30, 2006 and 2005:

**(In thousands)**

| | **2006** | **2005** |
|---|---|---|
| Wholesale commission revenue | $ 620 | $ 732 |
| Amounts paid to wholesale third party | | (219) |
| Commission revenue, net | 620 | $ 513 |
| Dividend income | 721 | $ 383 |
| Dividend expense | (809) | (472) |
| Dividend expense, net | (88) | $ (89) |
| Asset management fees | 766 | |
| Interest income | 376 | 636 |
| Other | 339 | 12 |
| Total other revenues | $ 2,013 | 1,072 |

F-23

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(14) Receivable From and Payable to Brokers, Dealers and Clearing Organization**

Amounts receivable from and payable to brokers, dealers and clearing organization at September 30, 2006 and 2005 consisted of the following:

**(In thousands)**

| | Receivable | Payable |
|---|---|---|
| **September 30, 2006:** | | |
| Open securities transactions with clearing organization, net | $ 4,790 | $ |
| Securities clearing fees and related charges payable with clearing organization, net | | 165 |
| Open securities transactions with prime broker, net 762 | 2,026 | |
| Open commodities transactions | 1,386 | 2,168 |
| Open foreign currency transactions | 1,186 | 5,560 |
| | $ 8,124 | $ 9,919 |
| **September 30, 2005:** | | |
| Open securities transactions with clearing organization, net | $ 1,700 | $ 865 |
| Securities clearing fees and related charges payable with clearing organization, net | | 124 |
| Open commodities transactions | 829 | 24 |
| Open foreign currency transactions | 1,081 | 3,359 |
| | $ 3,610 | $ 4,372 |

Receivables and payables to brokers, dealers and clearing organization result from open trading activities between the Company and other financial institutions including banks, securities broker-dealers, market-makers and counter-parties. Receivables and payables to certain organizations are reported net, when a right of setoff exists with the broker, dealer or clearing organization.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(15) Receivable From and Payable to Customers**
Amounts receivable from and payable to customers at September 30, 2006 and 2005 consisted of the following:

**(In thousands)**

| | Receivable | Payable |
|---|---|---|
| **September 30, 2006:** | | |
| Open transactions- foreign currency trading | $ 10,661 | $ 543 |
| Margin deposits held - commodities trading | | 2,227 |
| Pledge and option premiums receivable - commodities trading | 4,525 | |
| Money management fees | 524 | 42 |
| Open transactions - other debt structures | 11,174 | |
| | $ 26,884 | $ 2,812 |
| **September 30, 2005:** | | |
| Open transactions- foreign currency trading | $ 10,397 | $ 1,998 |
| Margin deposits held - commodities trading | | 1,208 |
| Pledge and option premiums receivable - commodities trading | 5,168 | |
| Open transactions - other debt structures | 83 | |
| | $ 15,648 | $ 3,206 |

Receivables and payables to customers result from open trading activities between the Company and its customers. Receivables and payables to certain customer organizations are reported net, when a right of setoff exists with the customer.

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(16) Payable to Banks under Loans and Overdrafts**

At September 30, 2006, the Company had six lines of credit with five commercial banks totaling $70,000,000. Four of the credit facilities are secured by certain assets. Total interest expense related to the Company s credit facilities was approximately $1,371,000 for the year ended September 30, 2006. The interest rate terms for the facilities range from 2.25% to 2.75% over the London Interbank Offered Rates ( LIBOR ) (approximately 5.3% at September 30, 2006).

At September 30, 2006 the Company had the following credit facilities:

| Maximum Amount | Borrowing at September 30, 2006 | Letters of Credit Issued under facility | Security | Maturity |
|---|---|---|---|---|
| $ 10,000 | $ 2,534 | $ | Certain foreign exchange assets | March 31, 2007 |
| 12,000 | | | Unsecured | March 31, 2008 |
| 10,000 | | | Certain commodities assets | On demand |
| 18,000 | | 4,800 | Certain commodities assets | On demand |
| 10,000 | 4,000 | | Certain trade finance assets | On demand |
| 10,000 | | 8,347 | Certain commodities assets | March 27, 2007 |
| $ 70,000 | $ 6,534 | $ 13,147 | | |

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

At September 30, 2006 and 2005, the U.S. dollar equivalent of the components of the net borrowings under the credit facilities were as follows:

| (In thousands) | September 30, 2006 | September 30, 2005 |
|---|---|---|
| | U.S. dollar equivalent | U.S. dollar equivalent |
| Payable to Banks: banks: | | |
| Lines of credit | | |
| Australian Dollar | $ | $ 10 |
| Danish Krone | | 135 |
| Euro | 2,373 | 1,175 |
| Japanese Yen | 5 | |
| South African Rand | 35 | 314 |
| Swedish Krona | 63 | |
| Swiss Franc | 42 | 442 |
| Thailand Baht | 16 | |
| United States Dollar | 4,000 | 7,771 |
| Total payable under lines of credit | 6,534 | 9,847 |
| Overdrafts and borrowings | | |
| United States Dollar | | 3,000 |
| Total payable to banks under loans and overdrafts | $ 6,534 | $ 12,847 |

**(17) Capital and Cash Reserve Requirements**
INTL Trading is a member of the NASD and is subject to the SEC Uniform Net Capital Rule 15c3-1. This rule requires the maintenance of minimum net capital in an amount equal to the greater of $100,000, 6-2/3% of aggregate indebtedness, or $2,500 for each security in which a market is made with a bid price over $5 and $1,000 for each security in which a market is made with a bid price of $5 or less with a ceiling of $1,000,000, and requires that the ratio of aggregate indebtedness to net capital not exceed 15 to 1. Equity capital may not be withdrawn if the resulting net capital ratio would exceed 10 to 1. At September 30, 2006, INTL Trading s net capital was approximately $5,998,000, which was approximately $4,998,000 in excess of its minimum requirement of $1,000,000. Its ratio of aggregate indebtedness to net capital was .31 to 1.

INTL Trading is exempt from SEC Rule 15c3-3 pursuant to the exemptive provision under subparagraph (k)(2)(ii) and, therefore, is not required to maintain a Special Reserve Bank Account for the Exclusive Benefit of Customers .

**(18) Commitments and Contingent Liabilities**

The Company is obligated under various noncancelable operating leases for the rental of office facilities, service obligations and certain office equipment, and accounts for these lease obligations on a straight line basis. The expense associated with operating leases amounted to $1,130,000 and $891,000 for the years

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

ended September 30, 2006 and 2005, respectively. The expenses associated with the operating leases and service obligations are reported in the statements of operations in occupancy and equipment rental, clearing and related and other expenses.

Future aggregate minimum lease payments under noncancelable operating leases as of September 30, 2006 are approximately as follows:

| Year ending September 30, (In thousands) | |
|---|---|
| 2007 | $ 1,337 |
| 2008 | 983 |
| 2009 | 500 |
| 2010 | 190 |
| 2011 | 187 |
| Thereafter | 221 |
| | $ 3,418 |

In August 2005, the Company executed a clearing agreement with Broadcort. In December 2005, the Company began clearing its securities under this agreement. The agreement includes a $100,000 deposit and an initial term of three years. Thereafter there will be automatic one year renewal terms, unless the Company or Broadcort gives 90 days notice of its intention not to renew either at the end of the initial term or any succeeding one year renewal period. In the event the Company does not use this 90 day notice provision and terminates the agreement effective before the conclusion of the initial three year term or any automatic extension period, the Company will immediately owe the greater of 1) the sum of all continuing minimum payments ($25,000 per month) through the end of the initial term or extension period or 2) the total value of the clearing deposit at the time of termination.

The Company has entered into individual employment agreements with its Chief Executive Officer and President which currently expire on October 21, 2007. In the event of termination of the agreements by the Company other than for cause, or resignation by the executive as a result of a breach by the Company, each agreement provides for payments to the relevant officer in an amount equal to 100% of his total compensation for the longer of the remaining term of the agreement or six months.

The Company has entered into individual employment agreements with its Group Controller and Chief Financial Officer that each have an indefinite term. In the event of termination of either agreement by the Company other than for cause, or resignation by the officer as a result of a breach by the Company, each agreement provides for payments equal to 100% of total compensation for 120 days following date of termination.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(19) Income Taxes**

Income tax expense (benefit) for the years ended September 30, 2006 and 2005 consisted of:

**(In thousands)**

| | Current | Deferred | Total |
|---|---|---|---|
| **2006:** | | | |
| United States | $ (1,060) | $ 1,191 | $ 131 |
| United Kingdom | 1,543 | | 1,543 |
| State and local | (370) | 426 | 56 |
| | $ 113 | $ 1,617 | $ 1,730 |
| **2005:** | | | |
| United States | $ 282 | $ 207 | $ 489 |
| United Kingdom | 806 | | 806 |
| State and local | 115 | 74 | 189 |
| | $ 1,203 | $ 281 | $ 1,484 |

A reconciliation of the expected U.S. Federal tax expense, computed at the rate of 34% of income before taxes, to the actual tax expense for the years ended September 30, 2006 and 2005, is as follows:

| (In thousands) | 2006 | | 2005 | |
|---|---|---|---|---|
| | Amount | % of pretax income | Amount | % of pretax income |
| Computed expected tax expense | $ 1,789 | 34.0% | $ 1,400 | 34.0% |
| Increase (decrease) in income tax expense resulting from: | | | | |
| State income taxes, net of Federal income tax benefit | 30 | 0.6% | 121 | 2.9% |
| Meals and entertainment expenses not deductible for tax purposes | 35 | 0.7% | 25 | 0.6% |
| Memberships | | | 2 | 0.1% |
| Foreign income | (124) | (2.4)% | (65) | (1.6)% |
| Other, net | | 0.0% | 1 | 0.0% |
| | $ 1,730 | 32.9% | $ 1,484 | 36.0% |

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

Deferred income taxes as of September 30, 2006 and 2005 reflect the impact of temporary differences between amounts of assets and liabilities for financial statement purposes and such amounts as measured by tax laws. The temporary differences give rise to deferred tax assets and liabilities, which are summarized below as of September 30, 2006 and 2005:

**(In thousands)**

| | **2005** | **2005** |
|---|---|---|
| Gross deferred tax liabilities: | | |
| Accumulated depreciation and amortization | $ (2) | $ (46) |
| Joint venture investment tax basis timing differences | (303) | |
| Unrealized gain on OTC derivatives | (2,256) | |
| Deferred expenses related to total return swap | (10) | (20) |
| Total gross deferred tax liabilities | (2,571) | (66) |
| Gross deferred tax assets: | | |
| Securities valuation allowance | 19 | 23 |
| Nonqualified stock option expense | 12 | |
| Deferred revenue for total return swap | 35 | 69 |
| Expense of warrant value | 15 | 15 |
| Rent amortization | 36 | 28 |
| Federal and State net operating loss carryforwards 918 | 13 | |
| Contributions carryover | 1 | |
| Total gross deferred tax asset | 1,036 | 148 |
| Valuation allowance | | |
| Total net deferred tax assets | 1,036 | 148 |
| Net deferred tax (liability)/asset | $ (1,535) | $ 82 |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that a portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or the reversal of deferred tax liabilities during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. As of September 30, 2006, based upon the projections for future taxable income, management believes it is more likely than not that the Company will realize the benefits of these deductible differences and net operating loss carryforward, net of the recorded valuation allowance.

The total amount of undistributed earnings of INTL Global Currencies, the Company s foreign subsidiary, for income tax purposes, was approximately $5,376,000 at September 30, 2006. It is the Company s intention to reinvest undistributed earnings of its foreign subsidiary in the foreign jurisdiction, resulting in the indefinite postponement of the remittance of those earnings. Accordingly, no provision has been made for foreign withholding taxes or United States income taxes which may become payable if undistributed earnings of the foreign subsidiary were paid

as dividends to the Company. For the same reason, it is not practicable to calculate the unrecognized deferred tax liability on those earnings.

At September 30, 2006, the Company had a net operating loss carryforward for Federal income tax purposes of $2,136,000.

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(20) Employee Benefit Plan**

Effective January 1, 2003, the Company implemented a Savings Incentive Match Plan for Employees IRA ( SIMPLE IRA ). All employees are eligible to participate in the SIMPLE IRA upon the later of (a) the plan s effective date (January 1, 2003) or (b) the employee s date of hire. Eligible employees may elect to contribute up to a maximum of $10,000 ($12,500 if over age 50) for 2006. The Company is required to provide an employer match of the employee s elective deferral on a dollar-for-dollar basis not to exceed the lesser of 3% of the employee s compensation or $10,000 for 2006 ($12,500 if over age 50). Each employee is 100% vested in both the employee and employer contributions at all times. For the years ended September 30, 2006 and 2005, the employer match was $171,000 and $180,000, respectively.

Effective February 1, 2005, the Company offered its U.S.-based employees the opportunity to participate in a Flexible Spending Account (an FSA ). An FSA is a pre-tax benefit allowable under IRS Code section 125. It allows eligible employees to set aside a specific pretax dollar amount for unreimbursed medical, dental, and dependent care expenses. While the Company makes no contributions into these accounts, it does bear the cost of administration.

**(21) Stock Options and Warrants**

The International Assets Holding Corporation 2003 Stock Option Plan ( the 2003 Plan ) was adopted by the Board of Directors of the Company on December 19, 2002 and approved by the Company s stockholders on February 28, 2003. The 2003 Plan expires on December 19, 2012. The International Assets Holding Corporation Stock Option Plan ( the 1993 Plan ) was adopted by the Board of Directors of the Company and approved by the Company s stockholders on January 23, 1993 and expired on January 23, 2003. However, there are still outstanding options that were granted under the 1993 Plan. The 2003 Plan permits the granting of stock options to employees, directors and consultants of the Company. Stock options granted under either Plan may be incentive stock options meeting the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, or nonqualified stock options, which do not meet the requirements of Section 422. As of September 30, 2006, a total of 1,500,000 shares of the Company s common stock had been authorized for issuance pursuant to options granted under the 2003 Plan. The Company was authorized to issue up to 1,339,300 shares of the Company s common stock at the time that the 1993 Plan expired on January 23, 2003. At September 30, 2006 the total number of options outstanding was 985,930. The total options outstanding include 407,180 options outstanding under the 1993 Plan and 578,750 options outstanding under the 2003 Plan.

The Plans (meaning the 2003 and 1993 Plans) are administered by the Company s Board of Directors or a committee thereof. The Plans give broad powers to the Board of Directors to administer and interpret the Plans, including the authority to select the individuals to be granted options and to prescribe the particular form and conditions of each option. All options are granted at an exercise price equal to the fair market value or, in certain cases, not less than 110% of the fair market value of the Company s common stock on the date of the grant. Awards may be granted pursuant to the 2003 Plan through December 19, 2012, unless the Board of Directors at its sole discretion elects to terminate the 2003 Plan earlier. The Company is not authorized to grant additional options under the 1993 Plan because it expired on January 23, 2003.

At September 30, 2006, there were 575,568 additional shares available for grant under the 2003 Plan.

Using the Black-Scholes option-pricing model, the per share weighted average fair values of stock options granted during 2006 and 2005, where the exercise price equals the market price of the stock on the grant date, were $4.13 and $4.13, respectively. The per share weighted average fair value of stock options granted during 2006 and 2005, where the exercise price was greater than the market price on the grant date, was $5.04 and $4.37, respectively.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

The following weighted average assumptions were used:

| | 2006 | 2005 |
|---|---|---|
| Exercise price equal to the market price on grant date: | | |
| Expected risk-free interest rate | 4.35% | 3.29% |
| Expected life | 2.0 Years | 3.26 Years |
| Expected volatility | 83.9% | 87.7% |
| Exercise price greater than the market price on grant date: | | |
| Expected risk free interest rate | 4.37% | 3.27% |
| Expected life | 3.5 Years | 3.5 Years |
| Expected volatility | 84.4% | 88.4% |

Stock option activity during the fiscal years ended September 30, 2006 and 2005 was as follows:

| | Number of shares | Weighted average exercise price |
|---|---|---|
| Outstanding at September 30, 2004 | 1,282,006 | $ 2.37 |
| Granted | 149,550 | 7.64 |
| Exercised | (361,852) | 2.02 |
| Forfeited | (61,188) | 3.51 |
| Outstanding at September 30, 2005 | 1,008,516 | $ 3.21 |
| Granted | 198,800 | 10.36 |
| Exercised | (213,786) | 3.84 |
| Forfeited | | |
| Expired | (7,600) | 9.43 |
| Outstanding at September 30, 2006 | 985,930 | $ 4.47 |

At September 30, 2006 the range of exercise prices was between $0.90 and $23.58 and the weighted average remaining contractual life of outstanding options was 4.9 years.

At September 30, 2006 and 2005, the numbers of options exercisable were 738,126 and 620,232, respectively, and the weighted average exercise prices of those options were $2.88 and $2.42, respectively.

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

As of September 30, 2006, options outstanding, including their grant date, exercise price and expiration date, were as follows:

| Options outstanding | Grant date | Exercise price | Expiration date | Exercisable |
|---|---|---|---|---|
| 11,990 | July 20, 1998 | $ 2.40 | July 20, 2008 | A |
| 11,990 | January 6, 1999 | $ 1.25 | January 6, 2009 | A |
| 5,450 | December 9, 1999 | $ 7.17 | December 9, 2009 | B |
| 3,750 | March 10, 2000 | $ 11.63 | March 10, 2010 | A |
| 40,000 | March 9, 2001 | $ 3.13 | March 9, 2011 | D |
| 15,000 | October 5, 2001 | $ 0.90 | October 5, 2011 | C |
| 13,000 | April 11, 2002 | $ 1.40 | April 11, 2012 | D |
| 285,000 | December 6, 2002 | $ 2.50 | December 6, 2012 | C |
| 21,000 | December 6, 2002 | $ 1.30 | December 6, 2012 | D |
| 265,000 | March 7, 2003 | $ 2.50 | March 7, 2013 | C |
| 31,200 | November 14, 2003 | $ 4.75 | November 14, 2007 | D |
| 10,000 | May 11, 2004 | $ 6.51 | May 11, 2008 | D |
| 42,550 | November 18, 2004 | $ 7.45 | November 18, 2008 | E |
| 43,800 | November 18, 2004 | $ 8.57 | November 18, 2008 | F |
| 6,200 | November 18, 2004 | $ 8.57 | November 18, 2008 | G |
| 20,000 | December 1, 2004 | $ 7.35 | December 1, 2008 | E |
| 20,000 | June 8, 2005 | $ 6.23 | June 8, 2009 | E |
| 58,000 | December 2, 2005 | $ 8.80 | December 2, 2009 | E |
| 65,000 | December 2, 2005 | $ 10.12 | December 2, 2009 | E |
| 7,000 | May 8, 2006 | $ 11.81 | May 8, 2010 | E |
| 10,000 | September 1, 2006 | $ 23.58 | September 1, 2010 | E |
| 985,930 | | | | |

(A) Exercisable at 20% per year beginning one year from the date of grant.
(B) Exercisable at 20% per year beginning three years from the date of grant.
(C) Exercisable at 33.3% after year one, 33.3% after year two and 33.4% after year three. These options are 100% exercisable upon a change in control of the Company.
(D) Exercisable at 33.3% after year one, 33.3% after year two and 33.4% after year three.
(E) Exercisable at 33% after year one, 33% after year two and 34% after year three.
(F) Exercisable as to 16,500 options after November 18, 2005, 16,500 options after November 18, 2006 and 10,800 options after November 18, 2007.
(G) Exercisable as to 6,200 options after November 18, 2007.

As of September 30, 2006 and 2005, options covering 738,126 and 620,232 shares respectively, were exercisable. During the year ended September 30, 2006 and 2005, options covering 213,786 and 361,852 shares were exercised with a weighted average exercise price of $3.84 and $2.02, respectively.

The Company did not recognize any compensation expense in connection with the grant of stock options covering 198,800 shares during the year ended September 30, 2006 (this number includes stock options that were exercised during the year and that remain outstanding at the end of

the year), because the exercise price on the date of grant for each option was equal to or greater than the fair market value of the

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

common stock on the date of grant. During the year ended September 30, 2006, the Company recognized an additional $29,000 of non-cash expense related to the grant of 20,000 nonqualified stock options made on December 2, 2005 to two consultants of the Company in accordance with EITF Issue No. 96-18 and EITF Issue No. 00-18. The total expense of $29,000 was determined by utilizing an amortization period equal to the vesting period for the options and calculating the options value based on the Black-Scholes option pricing model.

*Warrants*

In 2004, the Company issued warrants covering 200,000 shares of common stock to the placement agent for the Company s offering of $12,000,000 in convertible subordinated notes. The warrants were exercisable by the holder at any time prior to June 30, 2007. The Company, at its option, had the right to require the warrant-holder to exercise all or any of the warrants in the event that all of the following conditions had been fulfilled: (i) the closing price of the Company s common stock had exceeded $9.00 per share for a period of twenty (20) consecutive trading days; (ii) the Company had filed a registration statement under the Securities Act of 1933, as amended, to register the resale of the shares of common stock issuable upon the exercise of the warrants; and (iii) such registration statement had been declared effective by the Securities and Exchange Commission. The warrants were exercisable at an exercise price equal to $6.00, subject to customary adjustment provisions. The conversion rights of the warrants were approved by the shareholders on March 26, 2004.

In the event, the warrants were exercised at the request of the Company in May 2006 at a price of $6.00. As of September 30, 2006, there were no warrants outstanding.

**(22) Preferred Stock**

The Company is authorized to issue 5,000,000 shares of its preferred stock at a par value of $.01 per share. As of September 30, 2006 and 2005, no preferred shares were outstanding and the Board of Directors had not yet determined the specific rights and privileges of these shares.

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

**(23) Quarterly Financial Information (Unaudited)**

The Company has set forth below certain unaudited financial data for the eight quarters in the fiscal years ended September 30, 2005 and 2006:

| (In thousands, except per share amounts) | Quarter Ended Dec. 31, 2004 | Quarter Ended Mar. 31, 2005 | Quarter Ended Jun. 30, 2005 | Quarter Ended Sep. 30, 2005 |
|---|---|---|---|---|
| Operating revenues | 6,086 | 6,157 | 6,282 | 7,615 |
| Interest expense | 177 | 296 | 314 | 548 |
| Net revenues | 5,909 | 5,861 | 5,968 | 7,067 |
| Total non-interest expenses | 4,915 | 5,279 | 5,070 | 5,421 |
| Income (loss) before income taxes and minority interest | 994 | 582 | 898 | 1,646 |
| Income tax expense | 375 | 197 | 298 | 614 |
| Income before minority interest | 619 | 385 | 600 | 1,032 |
| Net income | 612 | 379 | 576 | 1,047 |
| Net income per share - basic | 0.09 | 0.05 | 0.08 | 0.14 |
| Net income per share - diluted | 0.08 | 0.05 | 0.07 | 0.13 |

| (In thousands, except per share amounts) | Quarter Ended Dec. 31, 2005 | Quarter Ended Mar. 31, 2006 | Quarter Ended Jun. 30, 2006 | Quarter Ended Sep. 30, 2006 |
|---|---|---|---|---|
| Operating revenues | 8,331 | 9,021 | 14,111 | 4,414 |
| Interest expense | 529 | 477 | 621 | 468 |
| Net revenues | 7,802 | 8,544 | 13,490 | 3,946 |
| Total non-interest expenses | 6,120 | 6,858 | 8,247 | 7,296 |
| Income (loss) before income taxes and minority interest | 1,682 | 1,686 | 5,243 | (3,350) |
| Income tax expense | 637 | 596 | 1,956 | (1,459) |
| Income before minority interest | 1,045 | 1,090 | 3,287 | (1,891) |
| Net income (loss) | 1,045 | 1,090 | 3,287 | (1,962) |
| Net income (loss) per share - basic | 0.14 | 0.14 | 0.43 | (0.25) |
| Net income (loss) per share - diluted | 0.13 | 0.13 | 0.39 | (0.25) |

**Table of Contents**

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

## (24) Segment Analysis

International Assets Holding Corporation and its subsidiaries form a financial services group focused on select international securities, foreign currency and commodities markets. The Company s activities are currently divided into five functional areas: international equities market-making, international debt capital markets, foreign exchange trading, commodities trading and asset management. The Company s asset management activities will not be separately reported until certain asset and revenue levels are achieved.

The majority of the trading and market-making activities are undertaken as principal in order to provide institutional customers with efficient execution and liquidity in these markets. Periodically the Company takes proprietary positions in these markets.

*International Equities Market-Making*

Through INTL Trading, the Company acts as a wholesale market maker in select foreign securities including unlisted ADRs and foreign ordinary shares. INTL Trading provides execution and liquidity to national broker-dealers, regional broker-dealers and institutional investors.

*International Debt Capital Markets*

The Company actively trades a wide variety of international debt instruments including both investment grade and higher yielding emerging market bonds with particular focus on smaller emerging market sovereign, corporate and bank bonds that trade worldwide on an over-the-counter basis. The Company also arranges international debt transactions for issuers located primarily in emerging markets. These transactions include bond issues, syndicated loans, asset securitizations as well as forms of other negotiable debt instruments. The revenues, expenses, assets and liabilities relating to the Trust Certificate and Total Return Swap discussed in note 12 are included in this segment.

*Foreign Exchange Trading*

The Company trades select illiquid currencies of developing countries. The Company s target customers are financial institutions, multi-national corporations, governmental and charitable organizations operating in these developing countries. In addition, the Company executes trades based on the foreign currency flows inherent in the Company s existing international securities activities. The Company primarily acts as a principal in buying and selling foreign currencies on a spot basis. The Company derives revenue from the difference between the purchase and sale prices.

*Commodities Trading*

The Company provides a full range of trading and hedging capabilities to select producers, consumers, recyclers and investors in precious metals and certain base metals. Acting as a principal, the Company commits its own capital to buy and sell the metals on a spot and forward basis.

In accordance with the guidelines provided in EITF Issue No. 99-19, the Company has determined that revenues from the Company s base metals trading business should be reported on a gross basis because these commodities are physically delivered and not readily convertible to cash. All the Company s other businesses, including the precious metals trading business, also falling within the Commodities Trading segment, report their revenues on a net basis. Inventory for the base metals business is valued at the lower of cost or market value. The Company generally mitigates the price risk associated with base metals held in inventory through the use of derivatives. This price risk mitigation does not generally qualify for hedge accounting under GAAP. In such situations, unrealized gains in inventory are not recognized under GAAP, but unrealized gains and losses in related derivative positions are recognized under GAAP. As a result, the Company s reported commodities trading earnings are subject to volatility.

F-36

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

*Other:*

All other transactions that do not relate to the operating segments above are classified as Other . Certain cash accounts and balances were maintained to support the administration of all of the operating segments. These multi-segment assets were allocated to Other . Revenue reported for Other includes interest income but not interest expense; the gain or loss on the Company s asset management joint venture, which is accounted for by the equity method; and asset management fees in INTL Consilium, which has been accounted for as a variable interest entity and consolidated effective August 1, 2006.

The total revenues as reported for the year ended September 30, 2006, are not comparable with the total revenues reported for 2005 because they combine gross revenues for the physical base metals business and net revenues for all other businesses. In order to achieve comparability, and to reflect the way that the Company s management views the results, the tables below also reflect the segmental contribution to Operating revenues , which is shown on the face of the Consolidated Statements of Operations and which is calculated by deducting physical commodities cost of sales from total revenues.

Segment data includes the profitability measure of net contribution by segment. Net contribution is one of the key measures used by management to assess the performance of each segment and for decisions regarding the allocation of the Company s resources. Net contribution is calculated as revenue less direct cost of sales, clearing and clearing related charges and variable trader compensation. Variable trader compensation represents a fixed percentage of an amount equal to revenues produced less clearing and related charges, base salaries and an overhead allocation.

Inter-segment revenues, charges, receivables and payables are eliminated between segments, excepting revenues and costs related to foreign currency transactions done at arm s length by the foreign exchange trading business for the equity and debt trading business. The foreign exchange trading business competes for this business as it does for any other business. If its rates are not competitive the equity and debt trading businesses buy or sell their foreign currency through other market counter-parties. The profit or loss made by the foreign exchange trading business on these transactions is not quantifiable.

F-37

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

Information concerning operations in these segments of business is approximately shown in accordance with SFAS No. 131 as follows:

| | 2006 | 2005 |
|---|---|---|
| | (In thousands) | |
| Revenues: | | |
| International equities market-making | $ 17,994 | $ 12,052 |
| International debt capital markets | 2,363 | 2,414 |
| Foreign exchange trading | 12,874 | 9,213 |
| Commodities trading | 67,821 | 1,313 |
| Other | 1,709 | 1,148 |
| Total | $ 102,761 | $ 26,140 |
| Operating revenues: | | |
| International equities market-making | $ 17,994 | $ 12,052 |
| International debt capital markets | 2,363 | 2,414 |
| Foreign exchange trading | 12,874 | 9,213 |
| Commodities trading | 938 | 1,313 |
| Other | 1,708 | 1,148 |
| Total | $ 35,877 | $ 26,140 |
| Net contribution: | | |
| (Revenues less costs of sales, clearing and related expenses and variable trader bonus compensation): | | |
| International equities market-making | $ 9,353 | $ 5,450 |
| International debt capital markets | 1,995 | 1,654 |
| Foreign exchange trading | 9,879 | 7,082 |
| Commodities trading | (547) | 953 |
| Other | 781 | |
| Total | $ 21,461 | $ 15,139 |

Table of Contents

**INTERNATIONAL ASSETS HOLDING CORPORATION**

**AND SUBSIDIARIES**

Notes to the Consolidated Financial Statements

September 30, 2006 and 2005

| | 2006 | 2005 |
|---|---|---|
| | (In thousands) | |
| Total assets: | | |
| International equities market-making | $ 61,558 | $ 40,116 |
| International debt capital markets | 46,100 | 41,905 |
| Foreign exchange trading | 29,219 | 22,170 |
| Commodities trading | 41,792 | 34,881 |
| Other | 21,244 | 7,947 |
| Total | $ 199,913 | $ 147,019 |
| Reconciliation of net contribution to income before income taxes and minority interest: | | |
| Net contribution allocated to segments | $ 21,461 | $ 15,139 |
| Fixed costs not allocated to operating segments | 16,200 | 11,019 |
| Income before income tax expense and minority interest | $ 5,261 | $ 4,120 |

**(25) Subsequent Events**

$2 million of the Company s senior subordinated convertible notes ( the Notes ), plus accrued interest to the date of conversion, were converted in December 2006 into an aggregate of 79,562 shares of the Company s common stock. For further information on the Notes, see note 2 to the Consolidated Financial Statements.

**Table of Contents**

Exhibit Index

| **Exhibit No.** | **Description** |
|---|---|
| 21 | List of the Company s subsidiaries. |
| 23.1 | Consent of Rothstein, Kass & Company, P.C. to the incorporation by reference on Form S-8. |
| 23.2 | Consent of Rothstein, Kass & Company, P.C. to the incorporation by reference on Form S-3. |
| 31.1 | Certification of Chief Executive Officer, pursuant to Rule 13a 14(a). |
| 31.2 | Certification of Chief Financial Officer, pursuant to Rule 13a 14(a). |
| 32.1 | Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |